IN THE

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 32.

IRON ROSS, as Receiver of The First National Bank of Perry, Florida, *Petitioner,*

v.

W. V. KNOTT, as Treasurer of the State of Florida, et al., *Respondents.*

On Writ of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

REPLY BRIEF FOR PETITIONER.

I.

FURTHER DISTINCTIONS BETWEEN THE LEWIS CASE AND THE INSTANT CASE.

A substantial portion of Respondent's brief is devoted to attempting to show that the situation in the case of *Lewis, Receiver,* v. *Fidelity & Deposit Company of Maryland,* 292 U. S. 559, is almost exactly analogous in facts and *in principle to the instant case. Petitioner submits that* there is a very substantial difference in both respects.

In the Lewis case, as in the instant case, it was within the power of the bank to accept the deposit. In the Lewis

case the bank also gave a bond as required by state statute with surety, to guarantee the repayment of the deposit. The giving of the bond by the bank, undertaking to repay the deposit, constituted no more than a reiteration, in the form of a written contract or obligation, to do what it impliedly agreed to do at the time it accepted the deposit, to wit, to repay the same on demand as in other cases of deposit, and hence, we may assume, for purposes of discussion, that it was not beyond the power of the bank to give a bond nor in fact to give a surety bond. The situation at that point was that the other incident, to wit, the attaching of a lien upon the assets of the bank in consequence of giving of the bond, was ineffective, for the obvious reason that the state statute could not impose a lien upon the national bank's assets contrary to the National Banking Law, and hence the state statute attempting to impose such lien was simply inoperative.

However, it is an entirely different thing to dissipate the bank's existing assets by way of a pledge of them to secure a deposit contrary to law. This distinction is accurately depicted in the case of *Texas and Pacific Railway Company* v. *Pottorff*, 291 U. S. 245, 256, where this Court said, with reference to this distinction:

> "The fact that this bank had frequently secured private deposits by surety bonds lends no support to the contention that the power to pledge assets is necessary to carrying on the business of deposit banking. Such a practice would likewise be a departure from the policy of equal treatment of depositors; but the loss to other depositors resulting from such action would be far less serious. *A pledge withdraws capital assets, while the giving of a surety bond merely increases the bank's expenses.*" (P. 256; Italics inserted.)

Hence in the instant case the ultra vires pledging of assets to secure deposits in the First National Bank of Perry, Florida, in 1929 and 1930, prior to the Act of June 25, 1930, (12 U. S. C. 90) constituted, in the light of the *Texas and*

Pacific Railway v. *Pottorff case,* and *City of Marion* v. *Sneeden,* 291 U. S. 262, *an illegal dissipation of the assets of the bank,* as distinguished from a bond guaranteeing repayment of deposits.

Applying by analogy the doctrines established by this Court in the case of *Corsicana National Bank* v. *Johnson,* 251 U. S. 68, 86-87, the illegality attached to the transaction, *and the damage and injury to the bank became complete, the very moment of the dissipation of the assets under the pledge contract.* As stated in the Corsicana case (pages 86-87):

> "(5) Assuming the Fleming and Templeton notes were found to represent an excessive loan, knowingly participated in or assented to by defendant as a director of the Bank, in our opinion *the cause of action against him accrued on or about June 10, 1907, when the Bank through his act parted with the money loaned,* receiving in return only negotiable paper that it could not lawfully accept because the transaction was prohibited by Section 5200, Rev. Stats. *The damage as well as the injury was complete at that time,* and the Bank was not obliged to await the maturity of the notes, because immediately it became the duty of the officers or directors who knowingly participated in making the excessive loan to undo the wrong done by taking the notes off the hands of the Bank and restoring to it the money that had been loaned. Of course, whatever of value the Bank recovered from the borrowers on account of the loan would go in diminution of the damages; but the responsible officials would have no right to require the Bank to pursue its remedies against the borrowers or await the liquidation of their estates. The liability imposed by the statute upon the director is a direct liability, not contingent or collateral." (Italics inserted)

Under the doctrine of that case the assets remained illegally dissipated so long as they were outstanding. Hence it follows that the enactment of the statute of June 25, 1930 authorizing *future transactions* whereby the bank could

give security for repayment of deposits of public money of a state or political sub-division, could have no possible effect by way of validating a *previous* illegal dissipation of the bank's assets.

On page 34 of his brief Respondent seems to urge that the Act of June 25, 1930 cured the invalidity of the pledge contracts in the instant case, and says:

> "In support of this view, we feel that it should be borne in mind that this court has frequently held that *the invalidity of a contract made by a corporation in excess of its chartered powers may be cured by a subsequent act of the legislature, and that the contract is by such subsequent act, made as valid as if it had been originally authorized.* This clearly demonstrates that the want of legislative authority to enter into a contract *affects the remedy merely* and does not affect the *existence* of the contract itself. This would seem to follow because of the fact that the legislature would have no power to create a contract between the parties where there had been none before. That such vitality can be breathed into an original ultra vires contract, see the cases of Gross v. U. S. Mortgage Company, 108 U. S. 477, 488, 27 L. Ed. 795, 798; *West Side Belt* R. R. Co. v. Pittsburgh Construction Company, 219 U. S. 92, 55 L. Ed. 107; Charlotte Harbor & N. R. Co. v. Wells, 260 U. S. 8, 67 L. Ed. 100." (Italics inserted)

In response to the foregoing it may be observed, *first,* that the contracts or pledge in the instant case were absolutely void and constituted an illegal dissipation of assets, and remained such so long as the pledged assets were outstanding, and *second,* the cases above cited by Respondent involve statutes which were, either in express terms, or were construed to be, retrospective in operation, and curative of past *acts or transactions.* Obviously the Act of June 25, 1930 is not a statute of this type and it is clear from the Lewis case that it was intended to be prospective in operation, and to relate only to future transactions. As this Court said in that case:

"The appointment was within the power of the State to confer and of the bank to accept, but by reason of the paramount federal law one of the anticipated incidents of the relation, the lien, could not arise. When that obstacle was removed by the Act of June 25, 1930, *the original agreement could as to the future* be given the effect intended by the parties; and the lien became operative *as to deposits thereafter made and is entitled to priority from the date of the Act. A statute is not retroactive merely because it draws upon antecedent facts for its operation.* Compare Cox v. Hart, 260 U. S. 427, 435; Ewell v. Daggs, 108 U. S. 143; Petterson v. Berry, 125 Fed. 902; Hartford Fire Ins. Co. v. Chicago, M. & St. P. Ry. Co., 62 Fed. 904; 910; Rosenplanter v. Provident Savings Society, 96 Fed. 721. It was not necessary to go through the form of executing a new bond. Compare Jones v. Guaranty & Indemnity Co., 101 U. S. 622, 627. We have no occasion to consider whether the Act of June 25, 1930, would have validated the lien also in respect to deposits made before that date: Compare Gross v. United States Mortgage Co., 108 U. S. 477, 488; West Side Belt R. Co. v. Pittsburgh Construction Co., 219 U. S. 92; Charlotte Harbor & Northern Ry. Co. v. Welles, 260 U. S. 8." (Pp. 570-571; Italics inserted.)

It is obvious from the foregoing quotation:

First, that this Court considered that the Act of June 25, 1930 was *not* retroactive,—"A statute is not retroactive merely because it draws upon antecedent facts for its operation";

Second, that the bond contract was considered analogous to a mortgage or lien for *future advances* (citing in that connection *Jones* v. *Guaranty and Indemnity Company,* 101 U. S. 622, 627), and hence although the bond contract was ineffective until the advancements were made, when the advancements were *thereafter* made, that is to say, when the future deposits after the Act of June 25, 1930, were made, the lien could come into operation from the first effective date of the bond contract so far as its lien aspect was con-

cerned, to wit, from June 25, 1930, the date of passage of the enabling act.

It is true that this Court in the Lewis case said:

> "We have no occasion to consider whether the Act of June 25, 1930, would have validated the lien also in respect to deposits made before that date."

Petitioner reiterates, however, (in addition to what has just been said about the statute not being retroactive) that inasmuch as the instant case involves an actual illegal dissipation of assets through the ultra vires and void pledge contracts, certainly this situation is radically different, both in facts and legal effect, from the situation in the Lewis case where no assets of the bank had been dissipated by illegal pledge contracts *and where the bond contract did not and could not and had not dissipated or jeopardized the bank's assets,* and where the only question before the Court was the validity of the *future* deposits.

Certainly Congress never intended by the Act of June 25, 1930, to validate previous illegal dissipations of assets by the bank any more than it would intend, by enlarging the loan limits of a bank by amending Section 5200 U. S. R. S. (12 U. S. C. Sec. 84) relating to excessive loans, to thereby validate, by said amendment, previous illegal loans that were in excess of the permitted limits of the statute made prior to the amendment.

II.

THE PROCEDURAL STATUS OF THE CASE WOULD SEEM TO REQUIRE ITS REVERSAL FOR A HEARING UPON THE FACTS.

It must be borne in mind that the instant case is before this Court solely upon the pleadings, that is to say, upon the bill of complaint (R. pp. 1-22), and the motions to dismiss (R. 22-33).

The bill of complaint clearly sets forth illegal pledges of assets in 1929 and 1930 prior to the passage of the Act of June 25, 1930. The motion to dismiss necessarily admits those facts.

Hence it seems obvious that upon its face the bill of complaint stated a good cause of action, to wit, illegal dissipation of the assets by a pledge of the same to secure deposits prior to the Act of June 25, 1930. The motion to dismiss could not and did not set up extraneous facts contraverting that situation. Hence the trial court most certainly should have overruled the motions to dismiss and required the filing of an answer to bring out the facts. Those facts might have disclosed whether or not there was a new contract between the parties, or whether under all the facts and circumstances involved a new contract could be implied between the parties, etc.

In this connection may be noted the following language in the opinion of the trial court:

> "After the adoption of the Amendment of June 25, 1930, it is true that no deposits were made by the State Treasurer in the instant case, but there was a balance on deposit which remained due and unpaid until the Bank closed its doors in the latter part of October, 1930. *It is true, according to the allegations of the Bill, that the State Treasurer made no further deposits and that he did not call on the Bank to repledge its securities, but that he contented himself with the security pledged prior to the Amendment;* * * *" (R. pp. 36-37; italics inserted.)

Nothing appears in the bill of complaint averring or indicating the above quoted facts; apparently they were oral statements of counsel during the argument of the motion to dismiss, indicating such to be the facts, as seemingly otherwise the Court would not have made such statements in its opinion. Assuming for discussion that such oral statements were made during the course of the argument in the trial court, it is obvious that the disposition of the

case on its merits should not have been founded upon such statements, without evidence upon all of the facts relating thereto preceded by an answer setting forth the averments of fact intended to be relied upon by Respondents.

Considered from the standpoint of the merits, and aside from the procedural point, *and assuming for discussion only that the evidence would show* the ultimate facts to be as recited in the foregoing extract from the Trial Court's opinion:

> "that the State Treasurer made no further deposits and that he did not call on the bank to repledge its securities, but that he contented himself with the security pledged prior to the amendment * * **" (R. 36-37).

it is the position of petitioner that the pledge contracts, and the dissipation of assets thereunder, being illegal at the time made, remained illegal, and that merely leaving the money on deposit, without further action by either the bank or the depositor, did not change the status of illegality and that the Act of June 25, 1930, not being retroactive, did not cure the pre-existing illegality and consequently the Receiver is entitled to recover.

III.

ESTOPPEL AND THE EQUITIES.

Respondents were depositors in the bank. As such their equities are no greater than the equities of the general depositors of the bank. No principle of estoppel operates to prevent the recovery of the money by the receiver. As stated in *Texas & Pacific Railway Co.* v. *Pottorff, supra:*

> *"But even if the bank would have been estopped from asserting lack of power, its receiver would be free to challenge the validity of the pledge.* The unauthorized pledge reduced the assets available to the general creditors. It is the duty of the receiver of an insolvent corporation to take steps to set aside transactions which fraudulently or illegally reduce the as-

sets available for the general creditors, even though the corporation itself was not in position to do so.

"Third. The receiver may assert the invalidity of the pledge *without making restitution by paying the pledgee's claim in full.* * * * The pledge here challenged having failed because illegal, the Railway is entitled only to a dividend as a general creditor. Its right thereto is conceded." (Opinion pages 260-61. Italics inserted.)

The respondents are in no position to stand upon the fact that after the passage of the Act of June 25, 1930, the bank took no steps to recover the illegally pledged assets. Respondents were equally under obligation to restore to the bank the dissipated assets. If any question of guilt is involved, certainly respondents and the bank were in pari delicto.

It is respectfully submitted that the decision of the court below should be reversed.

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